Detailed Review of Stagflation and Recession

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Abstract. This paper thoroughly analyzes stagflation and recession along with their causes, effects and approaches to resolve them. Detailed literature on stagflation and recession provides value added analysis. In-depth review provides analysis about the history of stagflation, its effects and approaches to solve it. In addition, detailed reviews of recession, causes of major recessions, major sources of pressure for recession are thoroughly covered. Findings suggest that economies cannot completely avoid stagflation and recession, but they can reduce the effect of these factors on the economy.

Keywords: Economic theories, Stagnation, Recession.

1. Introduction to Stagflation and Recession

Stagflation takes place when an economy experiences slow growth, higher unemployment and inflation. Stagflation increases challenges for an economy to operate smoothly because slower economic growth, higher prices of goods and increased unemployment add more difficulties for an economy. It means that stagflation is directly and indirectly related to the lower performance of an economy and recession. Since the oil crisis in the 1970s, developed economies have experienced stagflations at different times. The three factors of stagflation increase overall difficulties for economists to deal with. In this scenario, if economists try to control one factor, then it can increase the negative effect of other factors. It means that if economists try to increase economic growth, then it can increase inflation. In mid-2022, experts started to discuss that the US may experience stagflation in the near future with their analysis highly relying on decreased economic performance and increased unemployment. Economists also said that during June 2022, there were higher chances of stagflation, but it did not take place. Their analysis showed that policymakers put huge emphasis on unemployment whereas they did not consider inflation first. In effect, inflation would have increased, and it would have created challenges for economists to deal with the issue of rising unemployment.

A technical recession is defined as negative GDP growth for at least 2 consecutive quarters. Recession takes place when the economy undergoes negative gross domestic product growth, higher unemployment, decreased retail sales, decreased income and lower production of manufacturing units. As per recession, it results in lower output of the economy, reduced consumer spending and lower employment opportunities. It means that recession leaves a huge negative effect on the economy as a whole. Recession is all about significant, consistent and widespread reduction in economic output. Data shows that the US has suffered 14 recessions since the period of Great Depression. Beyond the US, other countries also have experienced recessions as a part of their business cycle. In addition, the recession during Covid-19 was short whereas during the great depression it lasted for around a decade.

Stagflation and recession have similar effects on economic performance with huge negative effects on businesses and markets. Stagflation results in lower economic growth, high inflation and reduced employment, whereas recession is an economic period which results in lower economic activity. As per the close connection of both factors, it can be said that either factor results in lower economic performance and negative effects on business markets. It shows that stagflation and recession are also related to each other at some level. Therefore, it can be suggested that stagflation can also result in recession during an economic period. On the other hand, recession can also bring weak economic growth, high inflation and reduced employment where these factors are considered as the key segments of stagflation.

This paper thoroughly covers stagflation and recession with real world scenarios. In-depth analysis is covered in the following sections.
2. Causes of Stagflation and Recession

Causes of stagflation include but are not limited to tighter monetary policy, lower production of goods and services in the economy, increased consumer pricing index, and lower performance of the economy. These factors are considered to have direct and indirect effects on stagflation. Other causes of stagflation include sudden decreases in the supply of goods and services, bad monetary policy, mergers and acquisition. As per analysis, these factors can result in stagflation (Conerly, 2022).

Causes of recession include business and investment failure, economic factors, psychological and financial factors. These factors are considered to leave direct and indirect effects on the economy. Other key factors of recession include loss of investors’ confidence, higher interest rates and inflation, reduction in prices of real estate properties, mismanagement, and asset bubble burst. Assessment of these factors indicates that these factors leave a huge negative effect on the economy and bring recession. Additionally, investors’ confidence, higher interest rates and inflation, reduction in prices of real estate properties, mismanagement, and asset bubble burst need serious considerations from governments. If any of these factors are ignored, then there are higher chances of recession (Investopedia, 2022).

3. Literature Review

3.1 Literature Review on Stagflation

Several factors play their role in the overall existence of stagflation in the world. Since the incidents of the financial crisis in the 1970's, recently Covid-19 has had a compounding and damaging impact on the economies. The Russian invasion of Ukraine has magnified the slowdown in the global economy, which may make the overall growth feeble and elevate the inflation rate. The global economic growth is expected to slump from 5.7% in 2022 to 2.9% in 2022 and it is also expected that the stagflation impact will hover around global economies over 2023 and 2024. The challenge here is mainly for those businesses and economies who are already performing poorly. It is a real dilemma for economists to design strategies to avoid the impact of speculation by maintaining the current state of their economies. At the global level, the best way to avoid the consequences and impact of recession is to design national policies at the global level to save the economy. It is clear that distortionary policies like price controls, subsidies and export base cannot save the economy. The process of avoiding this whole situation for economies is to speed up the relief and expand vaccinations in low-income countries. In addition to that, supply and supply chains must be maintained to keep global commodity markets functioning well (World Bank, 2022).

Current times are reminiscent of the incident of global stagflation that happened in the 1970's. In recent times, stagflation fears are growing day by day across various global economies and the disappointing economic performance of countries has made it difficult for economists to comprehend the intensity of stagflation. The current inflation rates and disappointing economic activities are a clear indication that at a global level, economies are heading towards stagnation. This has created an alarming situation for investors and other businesses who mainly rely on the profits that they generate through market performance, which is mainly dependent upon strong demand for goods and services (The Economist Newspaper Limited, 2021).

The recent invasion of Russia on Ukrainian land has worsened the economic situation at the global level, creating stagflation globally. The war in Ukraine has brought substantial financial commodity price and supply chain shocks to the global economy, which are becoming harder to control day by day for most of the economies included the developed ones. In response to its invasion of Ukraine, Russia has been facing backlash from global economies that are sanctioning the Russian government on a variety of grounds. The impact of these sanctions is not limited to the Russian economy. This has mainly caused intense issues for supply in the energy market and commodity food prices, including wheat, grains and others. Economists believe that the recent invasion of Russia on Ukraine has added strength to the negative effects of Covid-19 on global economies. It is becoming harder and harder day-by-day for established economies to become immune to the disastrous influence of stagflation that is shadowing economies all over the globe (Otaviano Camuto, 2022).

It is hard for most of the economies and individuals to analyze the short-term and long-term effects of stagflation on economies and consumer choices. It is hard for most economists to predict the length of stagflation and its impacts on the economy and the lives of individuals. Stagflation heavily affects prices and unemployment, which rise simultaneously when the overall economic performance of global economies is declining. When the state of stagflation lingers then those effects become normalized by inhabitants, who start to make adjustments around the impacts of stagflation. There are hard choices that most of the economies have to make in order to reduce the effects of stagflation and bring their economies out of stagflation (Brunner, Cukierman and Meltzer, 1980).

3.2 Literature Review on Recession

Regardless of at what times a recession occurs there is a big problem that economic policy makers have to face while making national level economic policies. During a recession, policy makers sometimes make urgent decisions that may lead to uncertain consequences. Decision-making also generates problem uncertainty, mainly because of urgent economic issues experts make, in order to reduce the overall impact of recession. There are some challenges that mainly emerge when policymakers make urgent policies to avoid the negative effects of a recession. The problem occurs when all this policy making process happens without learning about the negative effects of solutions that were designed to tackle previous recessions. It is almost impossible to think of global economies experiencing a zero recession. Recession is inevitable; all that economic experts can do
is to make wiser policies that reduce the negative effects of recession to the minimum level with available resources (Lesch and Millar, 2022). There can be a number of reasons behind the occurrence of recession at the global level or among certain economies, but in recent times the major reason is Covid-19. The recent recession occurring at the global level is the result of labor shortage because of trading policies including immigration of workers from one nation to another nation. The second basic reason behind the occurrence of the recent recession is the nature of the policies that economic experts are making in order to handle the consequences of the recession. The policy-making procedures are also adding challenges for the economy to cover from the recent economic challenges happening due to the recession. It is in the best interest of global economies and economic policymakers to understand the real causes behind recession, find out their common factors and try to understand them so that economies at the global level can avoid future recessions or at least minimize their negative effects. It is easier to handle the negative effects of recession once policy makers understand the real causes behind recession. This leads policy makers and economies to take proactive approaches while designing counter recession strategies. It is impossible to avoid the negative effects of recession and recession itself but at least by understanding the real causes economic policy makers can minimize the overall negative effects of factors that are mainly responsible for recessions in the past and the recession through which the world is going at this time (Yagi, 2022).

Economies and businesses are always at risk, especially during recession times. The analysis of data from the past 10 recessions that the world has witnessed is evidence that businesses always suffer a lot during recessionary times. On average, more than 500,000 businesses suffer from failure because of the negative influence of a recession on a variety of their activities. Policymakers and businesses always struggle to manage the influence of crisis on their business activities and try to avoid or at least minimize their effect to maintain their full potential. The first major impact on business activities happens on the sales of products and services that are mainly responsible for generating a profit and paying for the wages of employees. When the initial activity of sales is not happening then this, directly and indirectly, affects the employment level of the businesses, which becomes hard to manage during a crisis. The best strategy that businesses and economies can follow in order to avoid or at least minimize the negative impact of the recession is to practice multi-channel business activity and trading policies. The application of flexible business policies makes it possible for most of the businesses to minimize the negative impact of recession and keep producing products and services that at least let those businesses remain in the industry without becoming bankrupt (Pearce and Michael, 2006).

Recessions affect every aspect of an economy, businesses and individuals. Recession has a negative impact on the stock market valuations, since it is a result of good or bad performance of companies on the basis of their supply chain activities and sales activities. Recession brings in great opportunities for investors when the overall stock prices are declining. This is because it leads to lower prices for investors, which become profitable once the stock market starts recovering from shocks of a recession. The negative effects of the recent recession due to labor shortage and Covid-19 influences are reflected by the negative performance of stock markets globally during that time. Individuals who liquidated their holdings during that time lost money because of the slump in the market. Contrary to those investors, individuals who will start investing during a recession may benefit from these deals after the recession is over and the stock market starts recovering. This not only brings in more investment opportunities for most of the calculated investors, but also brings challenges when the recession period lengthens (Sršoj, Škrinjarić, Radas and Walde, 2022).

4. Stagflation-In-depth Analysis

Stagflation takes place when an economy experiences slow growth, higher unemployment and inflation. Stagflation increases challenges for an economy to operate smoothly because slower economic growth, higher prices of goods and increased unemployment add more difficulties for an economy. This analysis covers historical incidents of stagflation, strategies for countries to avoid stagflation, possibility of stagflation these days, tactics for investors to mitigate the impacts of stagflation and analysis of whether the business cycle leads to stagflation or if supply shocks are the key factor. Detailed analysis is covered below.

4.1 Historical incidents of stagflation

One key historical incident of stagflation was the high oil price crisis of the 1970s in the US. During the 1970s, high oil prices resulted in higher inflation, lower economic output, increased unemployment, financial crisis, and lower interest rates. This is called the biggest case of stagflation when oil producing countries increased the prices of oil to a high level. As oil is the main source of energy, therefore, it resulted in higher energy costs and a sudden crisis. During the 1960s, economists believed that inflation and unemployment have an inverse relationship. Contrary to that narrative, the 1970s oil crisis changed the overall scenario. As per stagflation in the 1970s, unemployment and inflation increased at the same time which shows that stagflation neglected the very concept of the opposing relationship between unemployment and inflation. Other key concerns of stagflation in that period were the oil embargo, fluctuations in exchange rates, budget deficit and fluctuations in prices of goods and services. Due to the nature of these factors, an incident of stagflation took place (Nielsen, 2022).

During the era of Robert Mugabe, food production and supply shortage were mainly linked to the crisis which resulted in stagflation. At that time, Robert Mugabe created difficulties for white farmers which led to lower production of agricultural products. As white farmers were relatively skilled, therefore expelling these farmers directly resulted in lower production of food items. In effect, this brought a food shortage. This case clearly
shows that supply shortage also resulted from stagflation. As stagflation is linked to lower economic output, higher unemployment and increased prices, therefore, this is also one of the best examples during the 20th century (Pilkington, 2022).

4.2 How do countries avoid stagflation?
Countries can use different approaches to avoid stagflation. These approaches are to improve supply side policies, focus upon contractionary monetary policy, and develop price control mechanisms. These techniques can offer customized solutions to countries which can increase overall easiness of countries in dealing with stagflation. On the supply side, economies need to increase the overall productivity of factors of production. This increased productivity will again result in more production, higher supply and lower inflation rates. In addition, contractionary monetary policy, which involves central banks increasing the interest rates, is considered an effective tool to curb the effect of inflation (Agarwal, 2022). Price control mechanism is one of the effective tools which governments use to control inflation. For that pursuit, a government can set up standards and regulations where price control policy can help it to regulate the pricing of goods and services. In addition, local governments can use effective price control and regulation (Agarwal, 2022).

4.3 Are we heading for stagnation currently? Should investors be concerned?
As stagnation is the situation in an economy with low or flat growth. These days, different economists and market analysts have warned that markets can show stagnant growth in the future. In the case of bonds, investment consultants suggest that it is easier to predict the return and performance of the bond market. However, it is highly challenging to predict the return on investments in stocks and money markets when they predict that stagnation has higher chances of occurrence. In modern times, experts have warned that the world may experience another recession very soon. Overall analysis of the situation shows that investors should be worried about the investment market and need to focus investment in lower risk assets (The Wealth Advisor, 2022).

4.4 How can an investor mitigate the impacts of stagflation? What assets to hold/avoid?
Stagflation is the most difficult economic situation because it includes high inflation, slow growth and high unemployment. Stagflation also reduces the income of people and decreases their buying power. It is very necessary for investors and the general public to carefully make investment decisions (Boesler and Graffeo, 2022). What assets are good to hold and what assets must be avoided is discussed below.
Invest in Real estate
Economists suggest investing in real estate in order to avoid any loss and get fixed monthly rental income during stagflation. There are smaller chances that real estate may lose its worth because the population is increasing and people need homes. The demand for real estate will also increase. It is recommended to invest in real estate (Lake, 2022).
Invest in Gold and Silver
During stagflation people also prefer to invest in gold and silver because stagflation does not impact valuable metals. Investment in gold and silver will not generate any cash flow but it will save investors from losing currency value. Holding gold and silver is a better option than holding currency (Gambarini, 2022).
Invest in Value Stocks
It is also suggested that if investors want to invest in stocks then they must go for the value stocks. Value stocks are the type of stocks which are underpriced but due stagflation they are more undervalued. It is recommended to invest in these stocks because in the future when the economy comes back to normalization their price will increase and benefit investors.
Avoid growth stocks
Growth stocks are the stocks that suffer the most during a recession or period of stagflation. During stagflation the economic growth slows down and affects the performance of growth stocks, resulting in lower stock prices. It is therefore suggested to not invest in growth stocks during stagflation (Tan, 2021).

4.5 Can Business Cycle Lead To Stagflation? Or Supply Shock Leads to Stagflation
Some economists and theorists suggest that stagflation is the part of the business cycle which means that stagflation can occur naturally in the economy. In other words, stagflation is a crucial part of the business cycle. In stagflation, slow growth, higher unemployment and inflation are the key concerns whereas recession also has similar results. In a recession, lower economic growth, unemployment, and lower production are the main factors. At some level, stagflation has a similar problem. Considering all these factors, it can be suggested that a recession can take the form of stagflation and become another stage of the business cycle (Smith, 2021).
Supply shock results in reduced output and shortages of goods and services in the market. This shortage of supply of goods is called supply shock. As per the nature of supply shock, it results in high inflation, low purchasing power of buyers and lower economic growth, and lower business opportunities. Furthermore, supply shock is considered the main cause of stagflation in the market. During the era of Robert Mugabe, food production and supply shortage were mainly linked to the crisis which resulted in stagflation (Pilkington, 2022). Business cycles and supply shock can both lead to stagflation.
5. Recession-In-depth Analysis

This analysis thoroughly covers major historical recession causes, current sources of recession pressure, tactics to lessen the impact of recession, what to invest in during a recession and analysis of whether recessions are inevitable or not.

5.1 Major Historical Recession Causes-Financial Crisis 2007-2008 and US Great Depression

Examples of major recessions around the world include the financial crisis 2007-2008 and US Great Depression. This analysis thoroughly analyzes the causes of those two major recessions.

Causes of Financial Crisis 2007-2008: Major Recession

Causes of the financial crisis 2007-2008 include the collapse of the housing market in the US, problematic business activities of investors, banks, lenders and insurance firms, conflict of interests among parties involved and low governance from the government side. The financial crisis is considered as one of the biggest reasons for recession in the US, which affected the lives of millions of people. Financial issues came from shadow banking systems, lower financial regulations, higher investment in real estate with bank loans and a market bubble. Shadow banking systems and low regulations on real estate investment and lending were the two biggest concerns which brought the financial crisis and recession. Detailed review of the financial crisis 2007-2008 shows that mismanagement and low regulations on the real estate, banking sector and insurance were the main reasons for the recession (Singh, 2022).

Causes of US Great Depression

The Great Depression of the US lasted over ten years. The difficult period from 1929 to 1941 is mainly linked to the stock market crash of 1929, investment in the speculative market in 1920, mismanagement of money supply by the Fed, and rising inflation. Data analysis reveals that other reasons for the US Great Depression were rising prices of goods for businesses, bank panics, ineffective policies of the Fed and lower regulation. Given these points, it can be said that the US Great Depression took place because of various events occurring at the same time. Even though the US Government and the Fed tried to deal with the issues resulting from the stock market crash of 1929, investment in the speculative market in 1920, mismanagement of money supply by Fed and rising inflation, the downturn lasted over a decade (Segal, 2022).

5.2 Current Sources of Recession Pressure

One basic reason behind the recent incidents of recession happening at the global level is the Russia and Ukraine war. Besides The war has further exacerbated the negative effects caused by the Coronavirus. The World Bank has issued a statement saying that the risk of high inflation and low growth (stagflation) is high across all global economies. In addition to that, the lockdowns happening in China and supply chain disruptions are also the major causes behind the recent recessions at the global level, which have caused the risk of stagflation, which is hammering the growth process at the global level. It is evident that for most of the economy it is difficult to avoid the influence of the recent recession resulting from the Russia and Ukraine war and Coronavirus pandemic. It will be difficult for most of the economies to get rid of the negative influence of recession, which affects developed and underdeveloped economies across the globe. The only way out is to control the amateur policies which may worsen the whole situation (David, 2022).

China from where the whole Covid-19 issue started has now been another major cause behind the existence of the recent recession. It is estimated that the Zero Covid-19 policy by China may risk economic damage spiraling at the global level. The overall disruptions in the Chinese real estate market and other industries is also causing severe damage to the global economies who are directly and indirectly dependent upon the Chinese market for their industrial performance. Because of the Zero Covid policy, China has ultra-strict lockdowns. The policy has subjected cities to rolling lockdowns to try to contain the virus. In recent times, more than 200 million Chinese live under pandemic restrictions battering an already slowing economy (Waters, 2022).

5.3 Is Recession Coming or are we Already in a Recession?

Micro and macroeconomic activity experts indicate that most of the world economies are already living in a recessionary period. For some the situation is still under control and there is no recession now but chances are it may take place in the coming years. Most small businesses have already witnessed the negative influence of negative economic activities on their business operations through the decline in overall customer visits and purchases. Some American economic experts say that America is not in recession because of certain indicators including measures of income spending and job growth. However, despite the presence of these clear indicators most economists are still in doubt about the American market and its resistance to recessions impacting global economies. The recent statistics by the Bureau of Labor Statistics indicate that the annual inflation rate in May was 8.6%, its highest level since 1981. Which is a clear indication that the recession is already here; the world is yet to experience the worst of it (Casselman, 2022).

This is because the continuous increase in inflation rates is a clear indication of the probability of a recession that is going to happen soon across the globe. Moreover, companies have already started laying off their employees, cutting costs on unnecessary expenses. The median probability of a recession over the next 12 months is 47.5%, which is up from 30% in June. The major recessions are mainly defined and declared by the National Bureau of Economic Research, which says a significant decline in economic activity that is spread across the economy and that lasts more than a few months.

If one examines the current inflation trends and low performance of economies it is evident that most of the economies are already living in recessionary times. It is only a matter of time until the whole world will realize how difficult it is to survive when necessity goods start vanishing from the markets (Doutliery, 2022).
5.4 What can we do to avoid or lessen the impact of a recession?
Recession, inflation and stagnation are part of the economic cycle which countries face when their economic policy is not capable enough to counter the negative impacts caused by the economic activities of businesses in the market (Folger, 2022). The government of any country can control the economic activities with the help of fiscal policy and monetary policy. It is witnessed that the recession is the result of failure of fiscal policy and monetary policy formulated by the government. It is not possible to fully avoid the impacts of recession but people can minimize the impact of a recession on their daily life activities (Investopedia, 2022). People can avoid or lessen the impact of recession in the following ways: Spend less
It is witnessed that during a recession the economic and business activities slow down and many companies go for layoffs and terminate their employees. It is recommended by economists to spend less and save more during a recession in order to avoid any difficulty until the recessionary phase of the economy is passed and normalization is achieved (Perraton et al., 2022). Avoid loans
During recession people take loans due to very low interest rates. It is witnessed that people lose their jobs and spend their savings to pay off their loan installments, as a result they become bankrupt. In order to avoid any uncertain situation and avoid bankruptcy people must avoid taking unnecessary loans. Search for another source of income
It is also good to have another source of income other than one job because during a recession, companies go for layoffs and employees may lose their jobs. When you already have another source of income you may not face serious consequences after losing a job. Do not leave a job
Do not leave your job because it is providing you a fixed amount of money at the end of month. It is necessary to maintain employment and get fixed income in order to pay off your monthly utility expenses. If you are working for a stable company then you must not switch to an unstable or new company just because of the potential rise in pay. There are chances that new companies may not sustain and go for bankruptcy. It is also inadvisable to go for a new business during the time of recession because the chances of failure are higher.
5.5 What to invest in during a recession? What to avoid?
During recession invest in stable and low leveraged companies in order to achieve profits and avoid any unwanted issues (Frick, 2019). It is also suggested to invest in companies which are producing necessary goods and avoid investments in services sectors (Investopedia, 2022). Diversified investments
During a recession it is recommended to diversify your investments because the uncertainty level is very high in these scenarios. It is recommended to not invest in high leveraged companies but do invest in companies which are dealing in cash and have low debt to equity ratio. It is also advised to invest in companies which are producing necessity goods (Investopedia, 2022). Invest in IT companies
Many economists also suggest investing in information technology (IT) related companies because these companies require very few employees and perform their operations smoothly with the help of technology. IT related companies also provide an online platform and facility of work from home to save their office expenses (Frick, 2019). Adjustable Rate Mortgage
In times of recession it is advised for borrowers to go for adjustable rate mortgages and avoid fixed rate mortgages. In a recession, it is not clear how long the recession will prevail and when economic activities will come back to normalization. Avoid risky investments
Some investors are looking for an opportunity to earn huge profits in a very short time by investing in risky securities. During a recession it is not a good decision to make risky investments because the chances of bankruptcy are very high.
5.6 Are Recessions inevitable in the business cycle?
Economic theories and analysis describe a business cycle that revolves around growth, peak, recession and recovery or depression, which can also occur after recession has begun. In the perspective of capitalist economies, recession is a crucial part of the business cycle, which can occur after a peak. There is no denial that economies can deal with recession, but the recession is the key part of the business cycle which means that it is inevitable. Research also suggests that the United States has always focused upon bringing stable growth and development to the economy, but they can’t entirely prevent recessions due to their natural inevitability (Investopedia, 2022).

6. Conclusion
Detailed review of stagflation shows that it has direct and indirect connection with slow growth, higher unemployment and inflation. As per the nature of stagflation, inflation and unemployment increase at the same time which runs contrary to the old school of thought. In addition, a recession results in lower output levels in an economy, reduced consumer spending and lower employment opportunities. Considering the nature of both factors, economies need to develop specific approaches to deal with stagflation and recession where clarity in rules and regulations is compulsory for success in the market.
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